Financial Statements and Supplemental Material

Years Ended September 30, 2005 and 2004

APR 0 6 2006

Michigan Deptartment of Treasury 496 (2-04) Auditing Procedures Report

Issued und	er P.A. 2 of 1	968, a	s amen	ded.	T	L(CAL ALIDIT & C	WWA		
Local Government Type City Township Village Other Local Substance Abuse Services Local Government Name Local Government Name Health and Substance Abuse Services Kalamazoo						:00				
Audit Date 9/30/05				Opinion Date 1/19/06	.1	Date Accountant Report Su				
accordar	nce with th	ne S	tatem	ents of the Govern	mental Accou	government and rende inting Standards Boar int in Michigan by the N	d (GASB) and t	he <i>Unifor</i>	т Көрс	
We affirr	n that:									
1. We i	nave comp	lied	with th	ne Bulletin for the Au	dits of Local U	Inits of Government in	<i>Michigan</i> as revis	ed.		
2. We a	are certified	d pul	blic ac	countants registered	I to practice in	Michigan.				
	er affirm th		_	•	ave been disc	losed in the financial st	tatements, includ	ing the not	es, or in	the report of
You must	check the	арр	licable	box for each item b	elow.					
Yes	√ No	1.	Certa	ain component units/	funds/agencie	s of the local unit are e	excluded from the	financial	stateme	ents.
Yes	✓ No	2.		e are accumulated of 1980).	deficits in one	or more of this unit's	unreserved fund	balances	retained	d earnings (P.A.
Yes	√ No	3.		e are instances of inded).	non-compliand	e with the Uniform A	ccounting and B	udgeting /	۹ct (P.A	v. 2 of 1968, as
Yes	√ No	4.				tions of either an order the Emergency Munici		the Munic	ipal Fir	nance Act or its
Yes	√ No	5.				ents which do not com of 1982, as amended [N		/ requirem	ents. (F	P.A. 20 of 1943,
Yes	√ No	6.	The le	ocal unit has been d	elinquent in di	stributing tax revenues	that were collect	ed for ano	ther tax	king unit.
Yes	√ No	7.	pensi	ion benefits (normal	costs) in the	tutional requirement (A current year. If the pla equirement, no contribu	n is more than	100% fund	led and	the overfunding
Yes	√ No	8.		local unit uses cred . 129.241).	it cards and I	has not adopted an a	pplicable policy	as require	d by P.	.A. 266 of 1995
Yes	✓ No	9.	The lo	ocal unit has not add	pted an inves	tment policy as require	d by P.A. 196 of	1997 (MCI	⊾ 129.9€	5).
We have	enclosed	the	follov	wing:			Enclosed	To Forwa		Not Required
The letter of comments and recommendations.								✓		
Reports on individual federal financial assistance programs (program audits).										
Single Audit Reports (ASLGU).										
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Independent Auditors' Report

Kalamazoo Community Mental Health and Substance Abuse Services Kalamazoo, Michigan

We have audited the accompanying financial statements of Kalamazoo Community Mental Health and Substance Abuse Services (the Authority), a proprietary fund component unit of the County of Kalamazoo, Michigan, as of and for the years ended September 30, 2005 and 2004, as listed in the accompanying table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority, as of September 30, 2005 and 2004, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated January 19, 2006, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis and the Analysis of Funding Progress – Employee Retirement System information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards and Schedule of Federal Pass-Through Funds to Subrecipients, as required by U.S. Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and the Substance Abuse Prevention and Treatment Summary of Budgeted, Reported, and Audited Amounts and Schedule of Expenditures and Funding Sources by Program are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

BDO Sadran, LLA

Certified Public Accountants

Management's Discussion and Analysis

The following Management Discussion and Analysis (MD&A) of Kalamazoo Community Mental Health and Substance Abuse Services (the Authority's) activities and financial performance provide an introduction to the financial statements of the Authority for the fiscal year ended September 30, 2005. The Authority has been established by the County of Kalamazoo and state of Michigan to operate, control, and manage an integrated behavioral healthcare and substance abuse system in order to better serve its residents. The County Board of Commissioners appoints members to the Authority's board and provides financial support to the Authority on an annual basis. The Authority is considered a component unit for reporting purposes in the audit for the County of Kalamazoo.

Beginning in October, 2002, the Michigan Department of Community Mental Health contracted with the Authority as the designated Medicaid service provider or Prepaid Inpatient Health Plan (PIHP) for the geographic region in southwest Michigan which consisted of Kalamazoo, Allegan, St. Joseph, and Cass counties. Consequently, Kalamazoo PIHP has sub-contract agreements with each of these affiliate counties for the provision of these Medicaid services. Each county continues to hold independently the General Fund contract issued by the state as a Community Mental Health Service Program or CMHSP.

This contracting arrangement is expected to remain intact throughout fiscal year 2006.

The information contained in this MD&A should be considered in conjunction with the information contained in the financial audit conducted by BDO Seidman, LLP, for the year ended September 30, 2005. This MD&A contains information on the basic financial statements of the Authority together with any required explanation, which would be essential to acquire a full understanding of the data contained therein.

FINANCIAL POSITION SUMMARY

Analysis of assets, liabilities and net assets over time serves as a useful indicator of the Authority's financial position. The Authority's working capital, current assets of \$16,478,300 minus current liabilities of \$8,503,534 is positive at \$7,974,766. Additionally, the computation for net assets, total assets of \$19,457,408 minus total liabilities of \$9,166,609, is also significantly positive at \$10,290,799 as of September 30, 2005. This represents a positive increase of net assets for the year ended September 30, 2005, of \$221,812, or a 2.2% increase in net assets from the prior year ended 2004.

A condensed summary of the Authority's balance sheet is shown below:

September 30,	2005	2004
Assets: Current Net capital assets Net loan origination costs Long-term advances	\$ 16,478,300 2,926,631 14,477 38,000	\$ 17,841,178 2,862,695 16,733 149,029
Total Assets	19,457,408	20,869,635
Liabilities: Current liabilities Long-term debt	8,503,534 663,075	10,024,391 776,257
Total Liabilities	9,166,609	10,800,648
Net Assets: Invested in capital assets, net of related debt Unrestricted	2,150,374 8,140,425	1,978,983 8,090,004
Total Net Assets	10,290,799	10,068,987
Total Liabilities and Net Assets	\$ 19,457,408	\$ 20,869,635

Management's Discussion and Analysis (Continued)

The largest portion of the Authority's net assets (79.1% at September 30, 2005) represents its investment in reserves for equipment, employee retirement benefits, and internal service funds. Investment in capital assets net of outstanding mortgage debt is 20.9% of net assets. A complete description of the Authority's net assets can be found in Note 6 in the financial audit.

REVENUES

A summary of operating revenues for the fiscal year ended September 30, 2005, and the amount and percentage of change in relation to prior year amounts is as follows:

	2005 Amount	Percent of Total	Increase (Decrease) from 2004	Percent Increase (Decrease)
Operating Revenues:	\$	%	\$	%
Medicaid Revenue:				
Retained by PIHP	37,622,619	43.6	2,443,504	7.0
Sub-capitated to affiliate counties	27,216,504	31.5	1,057,308	4.0
General Fund/Other Revenues:			, ,	
State grants	13,347,834	15.5	256,479	2.0
Program fees and earned revenue	720,967	0.8	(293,203)	(28.9)
Federal grants	937,340	1.1	(99,447)	(9.6)
Other	315,918	0.4	(269,180)	(46.1)
Substance Abuse Revenue	6,174,466	7.2	691,624	12.6
Total Operating Revenues	86,335,648	100.0	3,787,085	4.6

EXPENSES

A summary of operating expenses for the fiscal year ended September 30, 2005, and the amount and percentage of change in relation to prior year amounts is as follows:

	2005 Amount	Percen of Tota	(200,0000)	Percent Increase (Decrease)
_	\$	%	\$	%
Operating Expenses:				
MI adult population	21,940,902	24.9	852,567	4.0
DD population	21,217,546	24.1	716,350	3.5
SED population	5,041,654	5. 7	(5,156)	(0.1)
Substance abuse population	6,243,832	7.1	777,170	14.2
Sub-capitated to affiliate counties	27,216,504	30.9	1,128,122	4.3
Management and general	5,674,178	6.5	489,222	9.4
QAAP expense	706,856	0.8	706,856	100.0
Total Operating Expenses	88,041,472	100.0	4,665,131	5.6
Fiscal Year Ended September 30,			2005	2004
Operating loss Net non-operating revenue Kalamazoo County transfer		\$ ((1,705,824) \$ 377,236 1,550,400	(827,778) 96,255 1,550,400
Increase in Net Assets			221,812	818,877
Net Assets, beginning of year		1	0,068,987	9,250,110
Net Assets, end of year		\$ 1	0,290,799 \$	10,068,987

Management's Discussion and Analysis (Concluded)

OPERATIONAL HIGHLIGHTS

- The SED population children's services unit was notified of its successful award of a Substance Abuse and Mental Health Services Administration (SAMHSA) grant. This is a multi-year, multi-million dollar grant which will be implemented in fiscal year 2006.
- The SED population children's services unit was relocated to 432 Crosstown Parkway in Kalamazoo.
 This will provide one singular focal point for all SED services.
- Substance Abuse services was awarded a \$215,500 Methamphetamine Grant, which is also a multi-year
 grant designed to build a community coalition in the CA region to develop education and community
 safety programming.
- The integration of the Substance Abuse Access Center for intake and referral services was added to the KCMHSAS service array at our 418 Kalamazoo Avenue location. This will enable coordinated assessments for MIA and SA consumers in one location.

SUMMARY OF CASH FLOW ACTIVITIES

The following shows a two year comparison of the major sources and uses of cash:

Fiscal Year Ended September 30,	 2005	2004
Net cash provided by (used in) operating activities Net cash provided by non-capital financing activities Net cash provided by (used in) investing activities Net cash used in capital and related financing activities	\$ (3,375,304) 1,550,400 2,155,173 (478,101)	\$ 3,382,936 1,550,400 (4,583,580) (215,197)
Increase (Decrease) in Cash	(147,832)	134,559
Cash, beginning of year	 196,279	61,720
Cash, end of year	\$ 48,447	\$ 196,279

FINANCIAL STATEMENTS

The Authority's financial statements are prepared on an accrual basis in accordance with accounting principles generally accepted in the United States of America promulgated by the Government Accounting Standards Board (GASB). The Authority also follows where appropriate, statements and interpretations by the Financial Accounting Standards Board (FASB). Revenues are recognized when earned, not when received. Expenses are recognized when incurred, not when paid. Assets are capitalized (except land and construction in progress) and are depreciated over their useful lives. Please see the notes to the financial statements for a summary of the board's significant accounting policies.

Respectfully submitted,

Cindy Lowe

Chief Administrative and Financial

Officer

Richard M. Jones, M. Director of Finance

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Statements of Net Assets

September 30,	2005	2004
Current Assets:		2004
Cash (Note 3)	\$ 48,447	\$ 196,279
Investments (Note 3)	13,538,703	15,271,551
Receivables:	10,000,700	13,271,331
Medicaid	386,376	397,485
Client service	915,687	781,513
Provider	132,533	-
Other	224,986	26,443
Due from state of Michigan	938,089	964,411
Prepaid and other current assets	293,479	203,496
Total Current Assets	16,478,300	17,841,178
Capital Assets, net of accumulated depreciation (Note 4)	2,926,631	2,862,695
Loan Origination Costs,		
net of accumulated amortization of \$8,084	14,477	16,733
Long-Term Advances to Sub-Recipient Agencies	38,000	149,029
Total Assets	\$ 19,457,408	\$ 20,869,635
Liabilities and Net Assets		
Current Liabilities:		
Accounts payable and accruals	\$ 5,928,911	\$ 7,580,423
Due to state of Michigan	1,663,194	1,071,933
Unearned revenue	798,247	1,264,580
Current maturities of long-term debt (Note 5)	113,182	107,455
Total Current Liabilities	8,503,534	10,024,391
Long-Term Debt, net of current maturities (Note 5)	663,075	776,257
Total Liabilities	9,166,609	10,800,648
Commitments (Notes 7, 8, 9, and 10)		
Net Assets (Note 6):		
Invested in capital assets, net of related debt	2,150,374	1,978,983
Unrestricted	8,140,425	8,090,004
Total Net Assets	10,290,799	10,068,987
Total Liabilities and Net Assets	\$ 19,457,408	\$ 20,869,635

Statements of Revenues, Expenses, and Changes in Net Assets

Year ended September 30,	2005	2004
Operating Revenues:		
Medicaid revenue:		
Retained by PIHP	\$ 37,622,619	\$ 35,179,115
Sub-capitated to affiliate counties	27,216,504	26,159,196
General Fund and other:		
State grants	13,347,834	13,091,355
Program fees and earned revenue	720,967	1,014,170
Federal grants	937,340	1,036,787
Other revenue	315,918	585,098
Substance abuse	6,174,466	5,482,842
Total Operating Revenues	86,335,648	82,548,563
Operating Expenses:		
Program services:		
MI adult population	21,940,902	21,088,335
DD population	21,217,546	20,501,196
SED population	5,041,654	5,046,810
Substance abuse population	6,243,832	5,466,662
Sub-capitated to affiliate counties	27,216,504	26,088,382
Management and general	5,674,178	5,184,956
QAAP expense	706,856	5,104,550
Total Operating Expenses	88,041,472	83,376,341
		, ,
Operating Loss	(1,705,824)	(827,778)
Non-Operating Revenue (Expense):		
Investment income	422,325	146,780
Interest expense	(45,089)	(50,525)
Total Non-Operating Revenue	377,236	96,255
Appropriations from Kalamazoo County	1,550,400	1,550,400
Increase in Net Assets	221,812	818,877
Net Assets, beginning of year	10,068,987	9,250,110
Net Assets, end of year	\$ 10,290,799	\$ 10,068,987

Statements of Cash Flows

Year ended September 30,	2005	2004
Operating Activities:		
Cash received from providing services	\$ 85,907,829	\$ 83,630,558
Cash paid to suppliers and affiliates	(82,508,517)	(73,192,730)
Cash paid to employees	(6,774,616)	(7,054,892)
Cash Provided by (Used in) Operating Activities	(3,375,304)	3,382,936
Cash Provided by Non-Capital Financing Activities -		
Transfers from Kalamazoo County	1,550,400	1,550,400
Capital and Related Financing Activities:		27.050
Proceeds from sale of land	(40= 4==)	37,858
Principal paid on mortgage payable	(107,455)	(102,019)
Interest paid on mortgage payable	(45,089)	(50,525)
Capital asset additions	(325,557)	(100,511)
Cash Used in Capital and Related Financing Activities	(478,101)	(215,197)
Investing Activities:		
Interest income	422,325	146,780
Sale of investments	10,231,383	4,526,721
Purchase of investments	(8,498,535)	(9,257,081)
Cash Provided by (Used in) Investing Activities	2,155,173	(4,583,580)
Increase (Decrease) in Cash	(147,832)	134,559
Cash, beginning of year	196,279	61,720
Cash, end of year	\$ 48,447	\$ 196,279

Statements of Cash Flows (Concluded)

ar ended September 30,	2005	 2004
econciliation of Operating Loss to		
Net Cash Provided by (Used in) Operating Activities:		
Operating loss	\$ (1,705,824)	\$ (827,778)
Adjustments to reconcile operating loss to		
net cash provided by (used in) operating activities:		
Depreciation and amortization	260,799	270,155
Loss (gain) on sale of fixed assets	822	(7,838)
(Increase) decrease in:		
Medicaid receivables	11,109	(12,254)
Client receivables	(134,174)	1,120,692
Provider receivables	(132,533)	-
Due from state of Michigan	26,322	(185,737)
Due from sub-recipient agencies	111,029	769,111
Prepaid and other current assets	(89,983)	27,273
Other receivables	(198,543)	(26,443)
Loan origination costs	2,256	2,256
Increase (decrease) in:		
Accounts payable and accruals	(1,651,512)	2,420,807
Due to state of Michigan	591,261	140,304
Deferred revenue	(466,333)	(307,612)

Notes to Financial Statements (Continued)

1. Nature of Organization

The Authority was created by the Kalamazoo County Board of Commissioners of Kalamazoo County, Michigan (primary government), to operate, control, and manage an integrated behavioral healthcare system in order to serve Kalamazoo County (the County). Prior to October 1, 1996, revenues and expenses, and the resultant assets, liabilities, and equity were blended with governmental funds and an account group in the primary government. The Authority is governed by a community mental health services board, which is appointed by the Kalamazoo County Board of Commissioners. The primary government also provides financial support annually to the Authority. Accordingly, the Authority is considered to be a component unit of the County and is discretely presented in the financial statements of the County.

On October 1, 2002, the Authority became the Prepaid Inpatient Health Plan (PIHP) to manage the delivery of a comprehensive array of specialty mental health and substance abuse services and support to a four-county region, which includes the counties of Kalamazoo, Allegan, Cass, and St. Joseph. The Authority provides services to Allegan, Cass, and St. Joseph counties by subcapitating to these counties, mental health funds received from the state of Michigan. The Authority also provides certain administrative services and support as the PIHP.

Also, effective October 1, 2002, the Authority became the coordinating agency of substance abuse services for Kalamazoo, Barry, Branch, St. Joseph, and Van Buren counties. This responsibility was transferred to the Authority from Kalamazoo County and included an equity transfer from the County of \$42,330.

2. Significant Accounting Policies

Basis of Accounting

These financial statements have been prepared using proprietary fund accounting. Revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual. The Authority follows all Governmental Accounting Standards Board (GASB) pronouncements and Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions, and Accounting Research Bulletins issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Revenues from premiums, state grants, client service, and federal grants are reported as operating revenues. Transactions that are capital, financing, or investing related are reported as non-operating revenues. All expenses related to operating the Authority are reported as operating expenses. Interest expense and financing costs are reported as non-operating expenses.

Investments

Investments consist primarily of certificate of deposits, commercial paper, money market accounts, and public funds investment trust accounts. Investments of the Authority are reported at fair value except commercial paper that has a maturity at the time of purchase of one year or less is shown at amortized cost.

Notes to Financial Statements (Continued)

Receivables and Payables

Accounts receivable, representing outstanding balances on charges for services, are considered fully collectible.

Transactions between the Authority and various departments of the state of Michigan that are representative of service provider/purchaser arrangements outstanding at year-end are reported as "due from/to state of Michigan."

Transactions between the Authority and various departments of the state of Michigan that are representative of borrowing arrangements that are outstanding at year-end are reported as "advances payable, state of Michigan."

Transactions between the Authority and sub-recipient agencies that represent the differences outstanding at year-end between amounts advanced to agencies and qualifying expenditures are included in accounts payable and accruals. All other outstanding balances between the Authority and agencies are reported as "advances to sub-recipient agencies."

Capital Assets

Capital assets are recorded at cost. Routine maintenance and repairs are charged to operations, as incurred. Upon sale or retirement, the related cost and accumulated depreciation are removed with the resulting gain or loss reflected in operations. The Authority's capitalization policy is all purchases greater than or equal to \$500 with a useful life of two years or more.

Depreciation is provided using the straight-line method over the following estimated useful lives:

Buildings and improvements 25-40 Years Equipment and furniture 3-20 Years

Net Assets

Designations of net assets represent tentative management plans that are subject to change.

Medicaid Revenue

The PIHP contract is for a two-year period beginning October 1, 2004, and is subject to cancellation by the state of Michigan upon 30 days written notice. Medicaid revenue is received monthly and is recognized as revenue during the period in which the Authority is obligated to provide services to members.

Unearned Revenue

Unearned revenue represents the portion of the current year CMH contract amount and other grant revenues that may be carried over to and expended in subsequent fiscal years. Such carryover is generally limited to 5% of the CMH contract amount.

Notes to Financial Statements (Continued)

Claims Liability

Under the State of Michigan's MCSSP, the Authority is responsible for processing and paying all claims related to required services provided. The cost of these services includes estimates of payments to be made on claims reported and estimates of services rendered but not reported to the Authority as of the balance sheet date.

Long-Term Obligations

Loan origination costs of long-term indebtedness are deferred and amortized over the life of the respective loan using the straight-line method.

Compensated Absences

Employees are granted sick and vacation leave in varying amounts based on length of service. Employees may accumulate up to a predetermined amount of vacation and sick leave in any one year. Upon termination, employees are paid for unused vacation at their current rates. Upon retirement, employees are paid for unused vacation and limited sick time at their current rates. It is the Authority's policy to recognize the cost of vacation and sick pay at the time the liability is incurred.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Classification

Certain amounts as previously reported have been reclassified to conform to current year classifications.

3. Deposits and Investments

Deposits

State statutes require that certificates of deposit, savings accounts, deposit accounts, and depository receipts are made with banks doing and having a place of business in the state of Michigan that are also insured by an agency of the United States.

The Authority's investment policy complies with the State statutes and has no additional limitations on deposits.

Notes to Financial Statements (Continued)

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that, in the event of bank failure, the Authority's deposits might not be recovered. The Authority does not have a policy for custodial credit risk over deposits. At September 30, 2005, \$3,123,036 of the Authority's bank balances of \$3,223,036 were exposed to custodial credit risk as follows:

Uninsured and Uncollateralized:

Money market	\$ 1,123,036
Certificates of deposit	2,000,000
Total Uninsured and Uncollateralized	\$ 3,123,036

Investments

State statues authorize the Authority to invest surplus funds in obligations or repurchase agreements of the United States or an agency of the United States, commercial paper, banker's acceptances of the United States banks, obligations of the state of Michigan or any of its political subdivisions, and mutual funds composed entirely of the above investments.

The Authority's investment policy complies with the State statues and has no additional investment policies that would limit its investment choices.

As of September 30, 2005, the Authority had the following investments and maturities:

		Investment Maturities Less than
Investment Type	Fair Value	One Year
Public Funds Investment Trust	\$ 4,476,348	\$ 4,476,348
Commercial Paper	6,676,000	6,676,000
Total	\$ 11,152,348	\$ 11,152,348

The Public Funds Investment Trust (PFIT) is a mutual fund comprised of United States Treasury Securities. These accounts are highly liquid and the Authority receives daily interest, compounded monthly, on the principal in these accounts.

Notes to Financial Statements (Continued)

Interest Rate Risk - Investments

Under State statues, investment in commercial paper is limited to maturities of not more than 270 days after the date of purchase. The Authority's investment policy complies with the State guidelines and seeks to minimize interest rate risk by investing primarily in short-term securities, liquid assets, money market funds or similar investment pools and limiting average maturities. The policy does not place specific limitations on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Because the Public Funds Investment Trust has a weighted average maturity of approximately 30 days as of September 30, 2005, it is presented as an investment with maturity of less than one year.

Custodial Credit Risk - Investments

Custodial credit risk is the risk that, in the event of a failure of the counterparty, the Authority will not be able to recover the value of its investments that are in the possession of an outside party. The Authority requires securities held by a third party custodian to be evidenced by safekeeping receipts. The Authority does not have any additional policies for custodial credit risk over investments.

Credit Risk - Investments

State statutes limits investments in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services. Investments in obligations of the State of Michigan or its political subdivisions must be rated as investment grade by not less than one rating service. Investments in bonds, obligations, or repurchase agreements must be made with the U.S. Treasury and bankers acceptances with U.S. banks. Mutual Funds must be comprised of the above investments.

The Authority's investment policy limits investments to be made with prudent judgment as to the safety of the invested capital and probable outcome of income.

At September 30, 2005, the General Electric commercial paper had a Standard & Poor's rating of A-1+, and Moody's rating of P-1. The PFIT has a rating of AAA by Standard & Poor's.

Concentration of Credit Risk

Except for U.S. Treasury Securities and authorized investment pools, the Authority limits the amount invested in a single security type or single financial institution to be no more than 60% of the total portfolio.

At September 30, 2005, the Authority had 60% of its total investment funds held in General Electric commercial paper. The Authority has all deposits and investments in accounts with one financial institution or affiliates of that financial institution.

Notes to Financial Statements (Continued)

4. Capital Assets

Capital asset activity was as follows:	Balance,				~	Balance,
	October 1, 2004		Increase	Decrease	Se	ptember 30, 2005
Capital assets not depreciated:						
Land	\$ 368,153	\$	_	\$ -	\$	368,153
Construction in progress (cost to complete not material)	56,252		146,481	59,293		143,440
Total capital assets not depreciated	424,405		146,481	59,293		511,593
Capital assets depreciated:						
Buildings	1,486,004		_	_		1,486,004
Equipment and furniture	1,884,562		165,449	3,174		2,046,837
Site improvements	1,198,443		72,920	, -		1,271,363
Vehicles	159,953		-	-		159,953
Total capital assets depreciated	4,728,962		238,369	3,174		4,964,157
Less accumulated depreciation:						
Buildings	590,416		124,382	-		714,798
Equipment and furniture	1,597,545		108,007	2,352		1,703,200
Site improvements	7,719		2,425	-		10,144
Vehicles	94,992		25,985	-		120,977
Total accumulated depreciation	2,290,672		260,799	2,352		2,549,119
Capital assets depreciated, net	2,438,290		(22,430)	822		2,415,038
Total Invested in Capital Assets, Net	\$ 2,862,695	\$	124,051	\$ 60,115	\$	2,926,631
Depreciation expense was charged to		lowe				
September 30,	iunctions as tor	iows.		2005		2004
		-				
MI adult population DD population				\$ 139,441	\$	144,406
SED population				59,683		60,539
Management and general				14,298 43,603		15,817
Substance abuse population				43,603 3,774		45,295 4,098
Total Depreciation Expense				\$ 260,799	\$	270,155

Notes to Financial Statements (Continued)

5. Long-Term Debt

Long-term debt consists of the following:

September 30,	2005	 2004
Mortgage payable to bank, secured by real estate and full faith and credit of the Authority, due in semi-annual installments of \$76,272, including interest at 5.26%, due October, 2011.	\$ 776,257	\$ 883,712
Less current maturities	 113,182	107,455
Total Long-Term Debt, less current maturities	\$ 663,075	\$ 776,257

Mortgage payable activity for the year ended September 30, 2005, was as follows:

	Balance October 1,					Sep	Balance September 30,		
		2004		Increase	Decrease		2005		
Mortgage payable issued in 2002	\$	883,712	\$	-	\$ 107,455	\$	776,257		

The annual requirement to pay principal and interest on the mortgage payable to maturity is as follows:

Year ending September 30,	Interest Payments	Principal Payments	Total
2006	39,362	113,182	\$ 152,544
2007	33,330	119,214	152,544
2008	26,977	125,566	152,543
2009	20,286	132,258	152,544
2010	13,237	139,307	152,544
2011	5,814	146,730	 152,544
Total	\$ 139,006	\$ 776,257	\$ 915,263

Notes to Financial Statements (Continued)

6. Net Assets

The Authority's net assets consist of the following:

September 30,	2005	2004
Net Assets:		
Total invested in capital assets Less:	\$ 2,926,631	\$ 2,862,695
Current maturities of long-term debt	(113,182)	(107,455)
Long-term debt, net of current maturities	 (663,075)	(776,257)
Total invested in capital assets,		
net of related debt	2,150,374	1,978,983
Unrestricted:		
Designated:		
Equipment replacement	905,628	859,952
Programs and employee benefits	1,575,143	1,575,143
Substance abuse	57,548	98,035
Managed care risk corridor	2,828,357	3,142,492
Undesignated	2,773,749	2,414,382
Total unrestricted	 8,140,425	8,090,004
Total Net Assets	\$ 10,290,799	\$ 10,068,987

7. Retirement Plans

Defined Benefit Plan

Plan Description

The Authority's defined benefit pension plan provides retirement, disability, and death benefits to plan members and beneficiaries. The Authority participates in the Kalamazoo County Employees' Retirement System, a Public Employee Retirement System (the Plan), which is an agent multiple-employer plan administered by the Kalamazoo County Employees' Retirement System.

The Authority establishes and amends the benefit provisions of the participants in the Plan. Separate financial statements are issued and may be obtained by writing the Kalamazoo County Employees' Retirement System, 201 W. Kalamazoo Avenue, Kalamazoo, Michigan 49007, or by calling 269-384-8008.

Notes to Financial Statements (Continued)

Funding Policy

The Authority is required to contribute at an actuarially determined rate. Employees are currently not required to contribute to the Plan. The contribution requirements of the Authority are established and may be amended by the Authority trustees.

Annual Pension Cost

For the years ended September 30, 2005 and 2004, the Authority's annual pension cost of \$536,088 and \$1,013,247, respectively, were equal to the required and actual contributions. The required contribution was determined as part of the December 31, 2004 and 2003, actuarial valuations, respectively, using the entry age actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of investment expenses), which includes an inflation component of 4.5% and (b) projected salary increases of 4.5% to 6.5% per year. The remaining amortization period for all liabilities at December 31, 2004, is 10 years.

Trend Information

Trend information consists of the following:

Fiscal Year Ended September 30,	Ended Pension Cost		Percentage of APC Contributed	Net Pension Obligation		
2003	\$	982,647	100%	\$	-	
2004	\$	1,013,247	100%	\$	-	
2005	\$	536,088	100%	\$	-	

Required supplementary material regarding the Plan is presented on Page 21.

Defined Contribution Plan

When the Authority became a separate legal entity, its employees elected not to participate in the Social Security System. To provide to its employees a similar retirement benefit, the Authority sponsored a 401(h) plan. Under the terms of this Plan, which is a defined contribution plan, both the Authority and its employees are required to contribute the same amounts that would be due if the Authority had elected to participate in the Social Security System. For the years ended September 30, 2005 and 2004, the Authority and its employees each contributed \$205,554 and \$218,469, respectively, on covered payroll of \$6,886,761 and \$7,016,313, respectively. The Authority is not a fiduciary with respect to the Plan and, accordingly, assets and liabilities of the Plan have been excluded from these financial statements.

Notes to Financial Statements (Concluded)

Other Postemployment Benefits

In addition to the pension benefits described above, the Authority provides postemployment health benefits in accordance with the requirements of an Authority resolution. Active participants of the defined benefit pension plan that retire at age 60 with eight or more years of service are eligible for this benefit. Currently, nine retirees are eligible for this benefit.

The Authority purchases commercial health insurance to provide this benefit, which is provided for the life of the retiree. The insurance policy provides coverage of medical expenses and costs for all pre-Medicare age retirees similar to the benefit available to active employees.

A reduced coverage policy, or Medicare supplement, is provided for each retiree eligible for Medicare. Dependent coverage, if requested, is financed by contributions by the retiree. Expenses for postemployment benefits are recognized on the pay-as-you-go method. During 2005 and 2004, expenses of \$130,121 and \$116,431, respectively, were recognized.

8. Claims Arising From Risks of Loss

The risks of loss arising from general liability, property, and crime, are minimized through participation in the Michigan Municipal Risk Management State Pool, a public entity risk pool currently operating as a common risk management program for government entities in the state of Michigan.

The Authority pays annual premiums to the state pool for insurance coverage up to a maximum of \$10,000,000 for aggregate general liability claim and \$5,205,000 for property and crime claims. In the event of unusually high claims, the state pool may assess member government units on a retroactive basis. The Authority purchases commercial insurance for risks of loss arising from employee health, medical, and workers' compensation claims.

9. Contingencies

Amounts received or receivable from grant agencies or third-party payers (principally Medicaid) are subject to audit and adjustment by grantor agencies or fiscal intermediaries. Any disallowed claims, including amounts already collected, may constitute a liability of the Authority. The amount, if any, or expenditures which may be disallowed by the grantor or, of excess reimbursements as determined by a fiscal intermediary, cannot be determined at this time, although the Authority expects such amounts, if any, to be immaterial.

10. Financing of Managed Care Risk Loss Corridor

The Authority operates as a managed care provider to the state of Michigan. The Authority bears all costs up to 107.5% of the annual negotiated contract. All costs above 107.5% are borne by the state of Michigan. The Authority has designated a portion of net assets (see Note 6) and funded an amount to cover the risk exposure under its contract with the state of Michigan.

Supplemental Material

Analysis of Funding Progress – Employee Retirement System

	(a) (b)		(b-a)	(a/b)	(c)	((b-a)/c)
Actuarial Valuation Date December 31,	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
1997	\$ 9,115,383	\$ 7,700,948	\$ (1,414,435)	118.4	\$ 6,309,426	(22.4)
1998	10,853,291	8,581,266	(2,272,025)	126.5	6,703,157	(33.9)
1999	12,839,276	9,891,968	(2,947,308)	129.8	6,948,912	(42.4)
2000	15,080,018	11,571,627	(3,508,391)	130.3	7,246,718	(48.4)
2001	17,053,135	13,017,823	(4,035,312)	131.0	7,458,238	(54.1)
2002	17,695,566	17,223,784	(471,782)	102.7	8,686,961	(5.4)
2003	16,153,856	13,782,313	(2,371,543)	117.2	7,395,382	(32.1)
2004	17,322,964	13,800,127	(3,522,837)	125.5	6,950,369	(50.7)



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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Kalamazoo Community Mental Health and Substance Abuse Services Kalamazoo, Michigan

We have audited the financial statements of Kalamazoo Community Mental Health and Substance Abuse Services (the Authority), as of and for the year ended September 30, 2005, and have issued our report thereon dated January 19, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted other matters involving the internal control over financial reporting, which we have reported to management in a separate letter dated March 1, 2006.

This report is intended solely for the information and use of the board, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Certified Public Accountants

BDO Sadran, LLP

January 19, 2006



211 East Water Street, Suite 300 Kalamazoo, Michigan 49007 Telephone: (269) 382-0170

Fax: (269) 345-1666

Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133

Kalamazoo Community Mental Health and Substance Abuse Services Kalamazoo, Michigan

Compliance

We have audited the compliance of Kalamazoo Community Mental Health and Substance Abuse Services (the Authority) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended September 30, 2005. The Authority's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2005.

Internal Control Over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the board, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Certified Public Accountants

BDO Sedman, LLA

Schedule of Expenditures of Federal Awards Year Ended September 30, 2005

Federal Grantor Pass Through Grantor	Federal CFDA Number	Federa Expenditure
Program Title	Number	Expenditure
U.S. Department of Health and Human Services:		
Passed Through Michigan Department of Community Health:		
Projects for Assistance in Transition from Homelessness	93.150	\$ 78,20
OBRA - Medical Assistance Programs	93.778	131,44
Block Grants for Community Mental Health Services:		
Wrap-around Respite Grant	93.958	11,23
Juvenile Justice Diversion Project	93.958	50,00
MIFPI Block Grant	93.958	50,00
Hispanic Grant	93.958	21,89
Togetherness Grant	93.958	23,58
MRC - Peer Support	93.958	21,05
Wellness Recovery Grant	93.958	15,40
Hope Pre Booking Jail Grant	93.958	27,13
Anti-Stigma Project - Supported Education	93.958	30,67
		250,98
Block Grants for the Prevention and Treatment of Substance Abuse	93.959	3,358,59
Passed Through Michigan Family Independence Agency -		
Promoting Safe and Stable Families	93.556	69,13
Total U.S. Department of Health and Human Services		3,888,36
U.S. Department of Housing and Urban Development:		
Direct Program - Supportive Housing Program	14.235	292,20
Direct Program - Shelter Plus Care Housing	14.238	7,68
		299,88
Total Expenditures of Federal Awards		\$ 4,188,24

Schedule of Federal Pass-Through Funds to Subrecipients

Program Name	Federal CFDA Number	Current Year
		\$
Ministry with Community - Homeless Outreach	93.958	13,261
MRC - Clubhouse Diabetes	93.958	22,540
MRC - Clubhouse Training	93.958	6,300
ACT Peer Support Advocate	93.958	12,655
ACT Peer Support Specialist - Co-Occurring	93.958	12,655
ACT Peer Support Specialist - Case Management	93.958	12,655
Block Grants for the Prevention and Treatment of Substance Abuse	93.959	1,121,367

Note to Schedule of Expenditures of Federal Awards Year Ended September 30, 2005

Note 1

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Authority and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in or used in the preparation of the financial statements.

See accompanying independent auditors' report.

Summary of Auditors' Results and Schedule of Findings and Questioned Costs

Section I – Summary of Auditors' Results	
Financial Statements	,
Type of auditors' report issued:	Unqualified
Internal control over financial reporting: • Material weakness(es) identified?	No
• Reportable condition(s) identified that are not considered to be material weaknesses?	None Reported
Noncompliance material to financial statements noted?	No
Federal Awards	
Internal control over major programs:	
Material weakness(es) identified?	No
• Reportable condition(s) identified that are not considered to be material weaknesses?	None Reported
Type of auditors' report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) or <i>Circular A-133</i> ?	No
Identification of major programs:	
CFDA Number(s) Name of Federal Program or Cluster	
93.959 Block Grants for the Prevention and Treatment of Substance Abuse	
Dollar threshold used to distinguish between Type A and Type B programs	\$ 300,000
Auditee qualified as low-risk auditee?	Yes
Section II – Financial Statement Findings	
No matters were reported.	
Section III - Federal Award Findings and Questioned Costs	

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

Substance Abuse Prevention and Treatment Summary of Budgeted, Reported, and Audited Amounts – September 30, 2005

Fund Source	Budgeted	Reported	Audited Expenditures	Reported/ Audited Variance	Local Match
A. State Agreement		<u> </u>			
Community Grant	\$ 3,068,120	\$ 3,051,770	\$ 3,051,770	\$ -	\$ -
SDA	43,431	29,216	29,216	-	-
SIG	147,301	147,301	147,301	-	-
Methamphetamine	130,308	130,308	130,308	-	
A. Subtotal	3,389,160	3,358,595	3,358,595	-	
B. Medicaid					
Current Year PEPM (Federal and State)	1,348,807	1,429,478	1,481,146	51,668	-
Reinvestment Savings	65,899	76,224	24,555	(51,669)	
B. Subtotal	1,414,706	1,505,702	1,505,701	(1)	•
C. Adult Benefit Waiver (ABW)					
Current Year PEPM (Federal share only)	80,594	76,990	76,990	•	-
C. Subtotal	80,594	76,990	76,990	•	-
D. MI Child	·	•			
Current Year PEPM	5,789	900	900	-	-
D. Subtotal	5,789	900	900	-	-
E. Local					
Current Year PA2	794,865	843,323	843,323	-	843,323
PA2 Fund Balance	176,326	-	-	-	-
Other Local (R325.4152 excluding subsection (1)(b))	85,389	84,796	84,796	-	84,796
E. Subtotal	1,056,580	928,119	928,119		928,119
F. Fees and Collections - Subtotal (R325.4151 (1)(d))	145,161	177,416	177,416	-	177,416
G. Other Contracts and Sources (Subtotal)	2,000	12,241	12,241		-
Grand Total of Subtotals	\$ 6,093,990	\$ 6,059,963	\$ 6,059,962	\$ (1)	\$ -
Amount Billable to MDCH (Section <u>A</u> audited subtota Total MDCH Payments	al)		\$ 3,358,595 3,389,340		
(Overpayment)/Underpayment			\$ (30,745)		
Local Match Funds Total Local Match Requirement [(Grand Total of Audited I	Expenditures-I	B-C-D-G) * 10	%]		\$1,105,535 446,413
Local Match (Shortfall)/Excess	-	,	•	-	\$ 659,122

				Audited Expenditures							
	Final Budget (net of Fees	(Reported (net of Fees								
	and		and				Less		Less		
Program	Medicaid)		Medicaid)	_	Gross		Medicaid		Fees		Net
Central Administration	\$ 570,521	\$	570,521	\$	570,521	\$	236,009	\$	-	\$	334,512
Prevention	864,776		1,153,933		1,153,933		-		28,455		1,125,478
Treatment	4,002,019		3,689,830		3,689,830		1,237,362		148,441		2,304,027
Women's Specialty/CDR	268,546		251,900		251,900		32,330		520		219,050
HIV/Aids	72,519		56,169		56,169		-		-		56,169
SIG	147,301		147,301		147,301		-		-		147,301
Methamphetamine	130,308		130,308		130,308		-		-		130,308
Other	38,000		60,000		60,000				-		60,000
	\$ 6,093,990	\$	6,059,962	\$	6,059,962	\$	1,505,701	\$	177,416	\$	4,376,845

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Substance Abuse Prevention and Treatment Schedule of Expenditures and Funding Sources by Program – September 30, 2005

	Funding Sources															
	State	- , , , , , , , , , , , , , , , , , , ,	SDA		Other Local		PA2		ABW		MI Child		Other	 Total Funding	Reported / Audited Variance	
\$	334,512	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$ 334,512	\$	-
	731,854		-		26,532		359,007		-		-		8,085	1,125,478		-
	1,752,235		29,216		58,264		382,266		76,990		900		4,156	2,304,027		-
	177,000		-		-		42,050		-		-		-	219,050		-
	56,169		-		-		-		-		-		-	56,169		-
	147,301		-		-		-		-		-		-	147,301		-
	130,308		-		-		-		-		-		-	130,308		-
	<u>-</u>		-		-		60,000		_		-		-	 60,000		-
\$	3,329,379		29,216	\$	84,796	\$	843,323	\$	76,990	\$	900	\$	12,241	\$ 4,376,845	\$	_
	\$3,358,		•	•			·									
Re	conciliation (of N	1edicaid I	Mana	iged Care	Fun	ids (PEPM)	<u>: </u>								
PEPM payments received \$ 1,481,146																
	Medicaid savings c/o 24,556															
	Funds expended (1,505,701) Medicaid savings C/F 11,367									(1,505,701) 11,367						
	turned to PIH											\$	11,368			